(1) 89-63

No.

Supreme Court, U.S.
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CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

J. BRADLEY COHN and ELIZABETH R. COHN, on behalf of themselves and all others similarly situated,

—VS.— *Petitioner,*

UNITED STATES OF AMERICA,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR WRIT OF CERTIORARI

COUNSEL OF RECORD:

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Questions Presented For Review

(1) Has the Government been miscalculating interest on tax deficiencies since 1983?

(2) Is a class action the most efficent way to remedy this Government error?

Parties to the Proceeding

The caption of the case in this Court contains the names of all parties.

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Opinion Below

The opinion of United States Court of Appeals for the Second Circuit (App. B, infra, pp. B-1 to B-5) is reported in 872 F.2d 533 (1989). The opinion of the United States District Court for the Southern District of New York is unreported. (App. A infra, pp. A-1 to A-10).

Jurisdiction

The opinion of the United States Court of Appeals for the Second Circuit was entered on April 13, 1989. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

Statutory Provisions Involved

Pertinent statutory provisions involved are set forth in App. C, infra, pp. C-1 to C-3.

Statement of the Case

The Cohns, class representative for Petitioners, paid tax deficiencies to the Internal Revenue Service ("IRS") and claimed a refund on the grounds that the IRS had miscalculated the interest owing on the tax deficiencies. The IRS only imposed simple interest on the tax deficiencies through December 31, 1982. After that date the IRS imposed compound interest on the tax deficiencies including the simple interest accrued through December 31, 1982. The Cohns objected to the inclusion of the simple interest as part of the tax deficiencies on which compound interest was imposed.

It is undisputed that Congress changed the method for calculating interest on tax deficiencies beginning with interest accrued after December 31, 1982. Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, §344, 96

Stat. 635 ("TEFRA"). See App. C, infra, pp. C to C . The Second Circuit succinctly states the issue:

> "TEFRA permitted the IRS to compound interest daily on any tax owed as of December 31, 1982 and thereafter. The Cohns argue that such compound interest may be based only on taxes owed as of December 31, 1982, but not on the aggregate amount of taxes plus simple interest that had accrued to that date. This argument is without merit."

The Cohns filed their claim for refund with the IRS as a class action. When that was denied (no reasons were given by the IRS), the Cohns filed a Class Action Summons and Complaint in the United States District Court for the Southern District of New York on November 17, 1987 for a refund under 26 U.S.C. §7422 of the alleged miscalculations of interest by the IRS.

A motion for class action certification by Petitioners pursuant to Rule 23(c)(1)

of the Federal Rules of Civil Procedure and and Civil Rule 4(c) Southern District of New York was denied in a decision and opinion dated September 29, 1988 by Judge Sprizzo on the grounds that a class action was not the most efficient way to resolve the issues in this case. The court also granted Respondent's motion for a judgment on the pleadings on the grounds that the amendments to the tax law permit the IRS to impose interest upon the principal and simple interest due at the time the amendments went into effect.

Federal Jurisdiction in the court of first instance is confered by 26 U.S.C. §7422, 28 U.S.C. §1346(a)(1) and 28 U.S.C. Rule 23.

Reasons for Granting the Writ

By treating simple interest as a past due tax on which compounded interest may be imposed, the IRS has effectively repealed 26 U.S.C. §§6601(a) and 6601(e)(1) which requires that interest may only be imposed on past due interest and that interest does not become past due until a notice and demand has been sent to the taxpayer. These code sections reflect a long standing tax policy to impose interest on interest only after the taxpayer is notified of the amount he owes.

In enacting section 344 of TEFRA Congress had a three fold purpose: to increase the effective rate of interest under the Internal Revenue laws, to conform computation of interest to commercial practice and to eliminate any economic benefit that could accrue to taxpayers by delaying payment of their taxes pending the resolution of tax controversies. These goals were

achieved by changing the method of computing interest on unpaid taxes under the Code from simple interest to compound interest and by imposing compound interest on past due interest. These changes eliminated any incentive that taxpayers may have had prior to TEFRA to delay paying their tax since a rate of interest equivalent to the market rate would accrue on such unpaid tax until paid. In addition, if a taxpayer fails to promptly pay the interest owed after notice and demand, compound interest will be imposed on such past due interest. A similar concept is followed under section 6601(c), which provides that interest will cease to accrue on a tax deficiency if the Internal Revenue Service does not send a notice and demand for such tax deficiency within 30 days after a taxpayer files a waiver on assessment. If Congress is willing to abate the accrual of interest on tax where the taxpayer does not have

reasonable notice of the amount due, surely it is logical and fair for the Internal Revenue laws to impose interest on interest only after the taxpayer is notified of the amount he owes.

Interest is imposed by section 6601 on past due tax and past due interest. Sections 6621 and 6622 merely prescribe the computation of the applicable interest rate. The structure of the Code, the terms of sections 6601 and 6622 and the history and purpose of TEFRA section 344 support this interpretation.

The Government attempts to support its position on the basis of the legislative history of section 6622, Treasury Regulations issued under section 6622 and an explanatory revenue procedure. The legislative history of section 6622 does not indicate that Congress intended to impose interest on interest that is not past due. The Conference Report concerning H.R. Rep. No.

97-760, 97th Cong., 2d Sess. at 595-96, provides that "the compounding requirement [of section 6622] would apply to interest accruing after December 31, 1982, on amounts (including interest) remaining unpaid after that date." With regard to interest, this statement explains that interest imposed on interest after December 31, 1982, is to be compounded. However, interest is not imposed on interest under the Code except on past due interest. Thus, the legislative history confirms that beginning January 1, 1983, compound interest will be imposed on past due interest. The General Explanation of the Revenue Provisions of the Tax Equity and Fiscal Responsibility Act of 1982, prepared by the staff of the Joint Committee on Taxation, H.R. 4961, 97th Cong., 2d Sess. at 257, states as follows: "The compounding requirement applies in determining interest after December 31, 1982, on amount, whether principal or interest,

owing on or after January 1, 1983." Since interest is imposed under the Code only on past due tax and past due interest, this statement merely provides that compound interest will be imposed on past due tax and past due interest as of January 1, 1983. Under section 6601, interest is "past due" or "owing" only after the notice and demand has been made for such interest. Similarly, all of the legislative history of section 6622 is consistent with the position that TEFRA only authorized the imposition of compound interest on interest that is past due as of January 1, 1983.

The Government also relies on section 301.6622-1(c) of the Treasury Regulations, which were issued on August 22, 1983 (T.D. 7907), and Rev. Proc. 83-7, 1983-1 C.B. 583. Although these agency pronouncements are consistent with the Government's position, they should be declared invalid since they are contrary to

the unambiguous statutory language of section 6601 of the Code and are not based upon a reasonable interpretation of section 6622 of the Code. Vogel Fertilizer Co., 445 U.S. 16 (1982); and United States v. Cartwright, 411 U.S. 546 (1973).

The effect of the repeal of section 6601(e)(2) was to authorize for the first time since the enactment of the 1954 Code the imposition of intersest on past due interest. The 1939 Code did not contain a provision similar to section 6601(e)(2). Under the 1939 Code, simple interest was imposed on tax underpayments and on interest on a tax underpayment that was not promptly paid upon receipt of notice and demand for payment of such interest. Internal Revenue Code of 1939, §§292, 294(b); Rev. Rul. 54-426, 1954-2 C.B. 39; Committee Reports on H.R. 8300, Detailed Discussion of the Technical provisions of the bill and United States

v. Livingston, 381 F. Supp. 607 (D. Mass. 1974). The 1954 Code included section 6601(e)(2) specifically to prohibit the charging of interest on past due interest. Rev. Rul. 54-426. 1954-2 C.B. 39, 41. Thus, the repeal of section 6601(e)(2) by TEFRA was merely a return to imposing interest on past due interest as under the Internal Revenue Code of 1939.

The Code does not now and never has imposed interest on interest that is not past due, and no provision of TEFRA changed this long-standing rule. A departure from such a well-established rule cannot be effected by implication or by some strained construction of the Code, but only by a clear and direct Congressional mandate in the statute. The Government's method of calculating interest constitutes an unauthorized attempt to impose compound interest on interest that is not past due.

What possible reason is there for not extending the class to all taxpayers similarly aggrieved even though they had not filed a claim for refund? Can there be any doubt that the IRS would deny any claim that interest was miscalculated by the IRS computers?

It does not strain the reading of the jurisdictional requriements of 26 U.S.C. §7422(a) to hold that the class representative may file an administrative claim for individual unnamed class members where it is evident that individual claims would constitute a mere ministerial act. In Anderson v. John L. Hayes Construction Co., 1926, 243 N.Y. 140, 147, 153 N.E. 28, 29 Judge Cardozo stated: "The exemption of the sovereign from suit involves hardship enough where cosent has been withheld. We are not to add to its rigor by refinement of construction where consent has been announced." Hormel v. U.S., 11 F.R.D.

376 (1951). Further, it was noted in Hormel, at p. 377, that " . . . where the action is a class suit, . . . [i]ndependent grounds of federal jurisdiction are not required . . ." See 3B Moore's Federal Practice ¶23.95 (1987 Ed.) and Wheeler v. American Home Products (CA 5th, 1978) 582 F2d 891, cited at fn 8 therein.

The sensible and equitable approach to jurisdictional requirements in a tax class action is to ask the question: would an administriative hearing make a difference. In most tax refund cases it would, because there is an issue of tax liability that of necessity is unique to individual taxpayers and taxable years. Similarly, in Califano v. Yamasaki, 442 U.S. 682, 704 (1979), although jurisdictional requirements of unnamed claimants were not in issue, the court noted that

the requirement of a "final decision of the Secretary [of Health, Education and Welfare]" under §205(g) of the Social Security Act (42 U.S.C. §405(g)) must be met by individual class members, for the obvious reason that the outcome of the administrative hearing before the Secretary depends on the credibility of each claimant that he was entitled to keep overpayments of social security benefits.

What distinguishes this case from the usual tax case is that there is no issue of tax liability. Hence, the reasoning of Yamasaki at 698 that the usual venue requirements do not apply and that a nationwide class may be certified is more appropriate to the question of whether the class representative can establish the jurisdictional requirements of 26 U.S.C. §7422(a) on behalf of unnamed individuals who were victims of the IRS

miscalculation of interest. cf. Sorensen v. Secretary of Treasury of United States, 752 F. 2d 1433 (1985) aff'd 106 Sup. Ct. 1600 (1986) where class certification was permitted for claimants opposing wrongful reduction of tax refunds earmarked for the tax intercept program.

Appendix

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK
----------X

J. BRADLEY COHN, et al.,

Plaintiffs,

- against -

UNITED STATES OF AMERICA,

Defendant.

87 Civ. 8168

----------X

New York, N.Y.
Sept. 29, 1988

Before:

HON. JOHN E. SPRIZZO,

District Judge

APPEARANCES

MICHAEL BRAY
Attorney for plaintiff

RUDOLPH W. GIULIANI
United States Attorney for the
Southern District of New York
Attorney for Defendant

BY: GABRIEL W. GORENSTEIN
Assistant United States Attorney

THE COURT: This is an action in which two forms of relief are sought: (1) there is a motion by plaintiffs to certify a class action, and (2) there is a motion by defendant for judgment on the pleadings. I think everybody agrees that there are no factual issues to be resolved. The issue is one purely of law and therefore appropriate to be resolved. The issue is one purely of law and therefore appropriate to be resolved on a motion for judgment on the pleadings.

With respect to the application for class action certification, that motion is denied for the following reasons. The plaintiffs seek to have the action certified as a true class action, as opposed to a hybrid class action, on the theory that there is a common issue of law here as to whether or not the compounding of interest on principal and interest due as of the time the statute was amended is common to all

taxpayers and therefore should be resolved in a class action. The argument essentially is that the United States might just as well know all these issues have to be determined one way, and since the issue of law is common, that justifies certifying it as a class action.

At the outset the Court notes that there has been no case that has been brought to my attention in which a tax refund action has been allowed to proceed as a class action.

At the outset the Court notes that there has been no case that has been brought to my attention in which a tax refund action has been allowed to proceed as a class action.

The plaintiffs have the burden of demonstrating, on a motion for a class action certification, that their claims are typical and representative of the members of the class. Also, the plaintiffs have the burden

of showing that the class action is the most expeditious and efficient way to resolve the issue. The plaintiffs havenot carried that burden.

As the defendant correctly points out -- quite aside from all the issues which have been raised here with respect to whether venue is proper, which I am not entirely sure I accept because in any class action each of the members of the class may not meet the venue requirements of the forum court and I don't know that the IRS venue provisions are any more important in that regard than any other venue provisions -- the government has a persuasive argument that the plaintiffs' claims are not typical of all the members of the class simply because the government has the right in any tax suit to open up the tax return of any person who seeks a refund or sues for a refund or makes a claim for a refund. Therefore, to some

extent, to allow the plaintiffs to represent all of those people who may be entitled to refunds would be, in effect, putting the plaintiffs in a situation where they will make the decision for each of those taxpayers as to whether they should or should not seek a refund when those taxpayers may choose not to do so, and in a way which would not even permit them to opt out of the class. Plaintiffs argue, of course, that the class then can be limited to those taxpayers who have already filed claims for refunds. While that is a viable argument, the plaintiffs still have not demonstrated that the class action is the most efficient way to resolve this problem.

It seems to me that the only argument here is that because there is a common question of law it should be a class action. If that were the case, we would certify class actions in every

situation in which the same principle of law might be relevant to all the members of the putative class.

In fact, the most efficient way to resolve that issue is not by means of a class action which would require the Court to bring in a lot of other parties and make the litigation immeasurably more complicated, but rather to allow the plaintiff to take his appeal through the ordinary appellate process and obtain a determination which will have stare decisis or controlling effect with the Circuit or, if it goes that high, within the nation at large. That is the most efficient way to resolve a common question of law. No court has ever suggested that the mere possibility of stare decisis or precedential effect is a sufficient predicate for a class action. There are also other problems that militate against class action treatment that the government quite correctly points out in its brief, which is probably why no court has ever

allowed a class action in a tax refund case. The application for a class action certification is therefore denied.

With respect to the merits of the case, I think there are two principles of law which are dispositive. The first principle of law, as I have mentioned, is that where the statute on its face is clear, there is no need to defer to an interpretation of the agency and the Court may resolve the issue for itself. The second is that if the statute is unclear or ambiguous, the Court is required as a matter of law to defer to the agency interpretation so long as it is not inconsistent with the statute.

The issue in this case is whether or not, Congress having passed an amendment to the tax law in 1986 which removed a previous prohibition which prevented the IRS from collecting interest on interest, said amendment now permits the IRS, after the effective date of that statute, to impose

interest upon the principal and simple interest due at the time that that statute went into effect. Having looked at the statute, I have no difficulty in finding that the statute is clear on its face and forecloses any argument that the IRS is prohibited from doing that, for the following reason: Under the old law, one provision of the Internal Revenue Code included, within the definition of taxes, taxes plus any interest owing on those taxes. However, another provision of the Internal Revenue Code foreclosed the imposition of interest upon interest. So it was the practice prior to December 31, 1982, because of that provision, for the IRS not to impose compound interest. As of December 31, 1982, that prohibition was repealed. Therefore, there was nothing to prevent the IRS from imposing a tax based upon interest upon interest after December 31, 1982.

As of December 31, 1982, the taxpayer was liable for not only the tax owing

as of that date but the simple interest owing as of that date. So, as of December 31, 1982, when we go into the new period, there is nothing existing in the code which precludes the IRS from imposing a tax not only upon the principal amount of the tax owing but also the simple interest owing as of that date. The statute clearly permits the IRS to do that. But even if the statute were not clear, the agency's interpretation is perfectly consistent with the statute and its legislative history. The Court is required to defer to the agency interpretation if that interpretation is not plainly inconsistent with the statute, as the Court finds it is not. That being the case, the Court must defer to that interpretation; but it would have reached that conclusion even if the agency had not interpreted the statute in that way. There is nothing in the IRS statute that precludes the imposition of interest upon not only the principal owing

as of that date but also the simple interest owing as of that date. In short, the Court rejects the argument on the merits that the IRS must impose its compound interest rate based upon only the principal amount of the tax owing as of that time.

The government's motion for judgment on the pleadings is granted. The cross-motion for class action certification is denied. I will enter a final order accordingly.

Date of entry: September 29, 1988

UNITED STATES COURT OF APPEALS

For the Second Circuit

- - - - - - - - - - -

No. 985 August Term 1988

Argued: April 3, 1989 Decided: 4/13/89

Docket No. 88-6320

----------X

J. BRADLEY COHN and ELIZABETH R. COHN, on behalf of themselves and all others similarly situated,

Plaintiffs-Appellants,

- against -

UNITED STATES OF AMERICA,

Defendant-Appellee.

----------X

BEFORE: PRATT and MINDER, Circuit Judges.

Appeal from judgment of United States District Court for the Southern District of New York, John E. Sprizzo, Judge, awarding United States judgment on the pleadings and denying Cohns' motion for class certification.

Affirmed.

Michael Bray, New York, NY
(J. Bradley Cohn, of
Counsel),
for Plaintiffs-Appellants.

BENITO ROMANO, New York, NY
(Gabriel W. Gorenstein,
Nancy Kilson, of Counsel),
For Defendant-Appellee.

PER CURIAM:

J. Bradley Cohn and Elizabeth R. Cohn appeal from a judgment of the United States District Court for the Southern District of New York, John E. Sprizzo, Judge, awarding the government judgment on the pleadings and denying the Cohns' motion for class certification. The Cohns dispute the manner in which the Internal Revenue Service ("IRS") calculates interest on tax deficiencies. We affirm because the statutory language and legislative history of the relevant statute fully support the IRS' position. We write only because the matter, while simple and straightforward, is apparently one of first impression in this circuit.

For many years, the Internal Revenue Code prohibited the imposition of compound interest in calculating interest on tax deficiencies. As a result, the IRS exacted only simple interest on any taxes owed until the date of payment. That bar on compound interest was lifted by the Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, § 344, 96 Stat. 635 ("TEFRA"), TEFRA permitted the IRS to compound interest daily on any tax owed as of December 31, 1982 and thereafter. The Cohns argue that such compound interest may be based only on the taxes owed as of December 31, 1982, but not on the aggregate amount of taxes plus simple interest that had accrued to that date. This argument is without merit.

As the district court properly held, the statute is clear on its face and in no manner suggests that the IRS is prohibited from imposing compound interest

on taxes and simple interest due at the time that TEFRA went into effect. Indeed, the legislative history of TEFRA directly contradicts the Cohns' interpretation of the statute. The Conference Committee Report clearly states that the

> compounding requirement would apply to interest accruing after December 31, 1982, on amounts (including interest) remaining unpaid after that date.
>
> * * * *
>
> * * * In a case in which the principal portion of an obligation is satisfied, and interest remains oustanding, such interest will, of course, be compounded.

H.R. Conf. Rep. No. 97-760, 97th Cong., 2d Sess. 595-96 (1982) (emphasis added), reprinted in 1982 U.S. Code Cong. & Admin. News 1367-68. Since the conference report sets forth the final agreement of both houses, it is entitled to great weight in determining congressional intent. See, e.g., Demby v. Schweiker, 671 F.2d 507, 510 (D.C. Cir. 1981).

Accordingly, the judgment of the district court is affirmed. Because judgment was awarded on the pleadings, we find it unnecessary to reach the issue of whether the motion for class certification was properly denied.

Date of entry: April 13, 1989

26 U.S.C. §6622(a)
added by P.L. 97-248, §344(a)

SEC. 6622. INTEREST COMPOUNDED DAILY.

(a) General Rule. - In computing the amount of any interest required to be paid under this title or section 1961(c)(1) or 2411 of title 28, United States Code, by the Secretary or by the taxpayer, or any other amount determined by reference to such amount of interest, such interest and such amount shall be compounded daily.

26 U.S.C. §6601(a)

SEC. 6601. INTEREST ON UNDERPAYMENT, NONPAYMENT, OR EXTENSIONS OF TIME FOR PAYMENT, OF TAX.

(a) General Rule. - If any amount of tax imposed by this title (whether required to be shown on a return, or to be paid by stamp or by some other method) is not paid on or before the last date prescribed for payment, interest on such

amount at the underpayment rate established under section 6621 shall be paid for the period from such last date to the date paid.

26 U.S.C. §6601(e)(2)
repealed by P.L. 97-248, §344(b)(1)

"(2) No interest on interest. - No interest under this section shall be imposed on the interest provided by this section."

26 U.S.C. §7422(a)

SEC. 7422. CIVIL ACTIONS FOR REFUND.

(a) No Suit Prior to Filing Claim for Refund. - No suit or proceeding shall be maintained in any court for the recovery of any internal revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority or of any sum alleged to have been excessive or in any manner wrongfully collected, until a claim for refund

or credit has been duly filed with the Secretary, according to the provisons of law in that regard, and the regulations of the Secretary established in pursuance thereof.

26 U.S.C. §6601(e)(1)

(1) Interest Treated as Tax. - Interest prescribed under this section on any tax shall be paid upon notice and demand, and shall be assessed, collected, and paid in the same manner as taxes. Any reference in this title (except subchapter B of chapter 63, relating to deficiency procedures) to any tax imposed by this title shall be deemed also to refer to interest imposed by this section on such tax.